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**ARIZONA CORPORATION COMMISSION**

March 8, 2004

Chairman Marc Spitzer  
Commissioner William A. Mundell  
Commissioner Mike Gleason  
Commissioner Kristin Mayes  
All Parties in **Docket No. E-04230A-03-0933**

**In Matter of the Reorganization of UniSource Energy Corporation**

Dear Colleagues and Parties:

I have read Chairman Spitzer's letter asking for a thorough financial analysis of the proposed acquisition of UniSource Energy Corporation by Saguaro Utility Group. I agree that these issues regarding the resulting capital structure should be fully explored.

As I understand, Saguaro Utility Group is proposing to acquire UniSource Energy through a leveraged buyout (LBO) transaction. In a typical LBO, a small group of investors acquires a company in a transaction financed largely by debt. The debt is serviced with funds generated by the acquired company's operations, the sale of some of its assets, or a combination of these. The acquiring group expects to make a profit from the LBO, but the inherent risks can be considerable due to the disproportionate use of financial leverage, according to LBO experts.

Upon reflection, I would like Staff and the interested parties to examine further the consequences of the proposed transaction relating to the higher debt burden for the resulting utility holding company and its effect on the cost of capital to TEP, UNS Electric, and UNS Gas. At present, the companies comprising UniSource Energy are highly leveraged with a debt-to-total capitalization ratio of 80% on a consolidated basis. According to the application in this matter, the proposed transaction will result in the retirement of approximately \$260 million in debt obligations for TEP, but the holding company will see an estimated \$660 million in additional debt.

I would like the parties to answer these specific questions:

- Is the LBO structure appropriate from a business, regulatory and public policy perspective?
- Does the heavy use of financial leverage at the holding company level pose any risk to TEP, UNS Electric, UNS Gas, and their ratepayers?
- Should TEP, UNS Electric, and UNS Gas be owned by a private investors' group that gains ownership by taking on a high degree of debt?

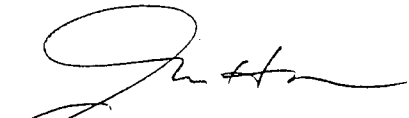
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- How will the credit ratings of TEP, UNS Electric, UNS Gas, and the resulting holding companies be affected by approval of this transaction?

If these questions give rise to other corollary issues, please examine them. I look forward to the parties' responses to the aforementioned questions.

Sincerely,

A handwritten signature in black ink, appearing to read "Jeff Hatch-Miller", with a stylized flourish at the end.

Jeff Hatch-Miller, Commissioner  
Arizona Corporation Commission

Cc: Docket